

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
HYMAN H. AND GERTRUDE KLEIN }

Appearances:

For Appellants: Nathan Schwartz, Certified Public
Accountant

For Respondent: A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Hyman H. and Gertrude Klein to proposed assessments of additional personal income tax in the amounts of \$407.95, \$8,513.38, \$1,279.94 and \$841.92 for the years 1950, 1952, 1953 and 1954, respectively.

Since the filing of this appeal Appellants have conceded the correctness of the proposed assessments for 1952 and 1953. The issues remaining are: (1) whether Appellants were California residents during the period April 8, 1950, to December 31, 1950, and (2) whether Appellants may deduct from their 1954 income all or part of certain legal expenses and fees incurred by Mr. Klein.

Appellants lived in Baltimore, Maryland, for many years prior to 1950, residing in a rented apartment. They had been in California only on brief visits. On one such visit in 1947 they purchased a lot in the Bel Air section of Los Angeles, with the intention of eventually becoming residents of California and constructing a home on the lot. On January 12, 1950, Appellants and their daughter, Elaine, arrived in Los Angeles, obtaining hotel accommodations. Soon after, Elaine entered the University of California at Los Angeles. On April 8, 1950, Appellants took a one-year lease on a house in the vicinity of Los Angeles. On April 18, Mr. Klein opened a bank account there. In the fall of 1950 Appellants began construction of a residence on the Bel Air lot they had purchased in 1947. The residence was completed in August, 1951, and Appellants moved in.

During the 8-3/4 month period between April 8, 1950, and December 31, 1950, Mr. Klein spent approximately 5-3/4 months in California, six weeks in New York, three weeks in Maryland, and three weeks elsewhere and in travel. The time spent in California covered four periods of from one to two months each. The time spent in the other-states consisted of brief periods of a few days at a time. Mrs. Klein spent more time in California during this

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period than did her husband as she did not accompany her husband on some of his trips to the east coast.

Mr. Klein remained a registered voter, maintained his mailing and business address, and retained his apartment in Maryland during 1950. The Maryland apartment was cared for by a maid. In June, 1950, her salary was reduced from \$25.00 to \$15.00 per week. The apartment was given up in April or May of 1951. Appellants filed a resident income tax return in Maryland for the year 1950 and paid a tax of \$3,537.86. For 1951 and subsequent years they filed resident tax returns in California.

It appears that Mr. Klein was not actively engaged full-time in business during the period in question. Other than dividends and interest from investments, which constituted the greater part of Appellants' income, the only other income was a fee from a New York firm.

During the year in question, the term "resident" was defined in Section 17013 (now Section 17014) of the Revenue and Taxation Code to include every individual who is in this State for other than a temporary or transitory purpose. The term as thus defined does not have the same meaning as domicile. One can be a resident of this State and thus subject to taxation on one's entire income even though domiciled elsewhere. (Title 18, California Administrative Code, Reg. 17013-17015(a).)

Appellants have asserted that the purpose of their stay in California in 1950 was to visit their daughter, that the house which they leased on April 8, 1950, was for her to stay in while attending school and that they did not intend to become residents until the following year. However, the uncontroverted facts show that after April 8, 1950, Appellants, as well as their daughter, occupied the leased house, that their absences from California were infrequent and of short duration, that they spent very little time in Maryland, the state in which they claim residence, and that they began construction of a home in Bel Air into which they moved upon its completion in 1951.

These facts establish that Appellants had commenced an indefinite stay in California by April 8, 1950, even though they had not entirely severed their connections with Maryland. Their intention not to become residents of this State until 1951 is not material under these circumstances. Similarly, the fact that they filed Maryland income tax returns as Maryland residents is of little significance. (See Title 18, California Administrative Code, Reg. 17013-17015(f).) This is especially true since the law of Maryland taxes as a resident any person who is domiciled there or who maintains a place of abode there for more than six months of the taxable year. (Sec. 279(i), Art. 81, Anno. Code of Md.)

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We conclude that Appellants were in California for other than a temporary or transitory purpose on and after April 8, 1950; and thus were residents within the meaning of the California law.

Appellants assert that they are entitled to deduct for the year 1954 some portion of amounts paid in that year as legal fees in a Federal criminal tax prosecution against Mr. Klein, which resulted in his conviction on one of several counts and dismissal of the others. At the time of the hearing on this matter the conviction was on appeal. Where a criminal prosecution results in conviction on one count, no part of the legal fees in defending against the prosecution is deductible, regardless of whether other counts are dismissed. (Michael and Rae Shapiro (International Trading Co.), T. C. Memo., Dkt. Nos 57352, 63560, May 29, 1958 aff'd Commissioner v. Shapiro, 278 Fed. 2d 556.) The deduction is properly disallowed even though the conviction is on appeal and the final outcome is unknown. (Joseph Cohen, T. C. Memo., Dkt. No. 110869, August 4, 1943.)

Appellants next claim as deductions under Section 17302.5 (now Section 17252) of the Revenue and Taxation Code legal fees and other expenses paid in 1954 in connection with litigation involving Appellants' civil liability for Federal income taxes for the years 1944 through 1946. Section 17302.5 allowed as a deduction "all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income,"

Expenses paid or incurred by an individual in contesting a liability asserted against him did not become deductible under Section 17302.5 by reason of the fact that property held by him for the production of income would be required to be used or sold for the purpose of satisfying such liability. Amounts expended in contesting a liability for taxes on income, however, were deductible as expenses "for the production or collection of income." (Personal Income Tax Regulation 17302.5.)

Although the deductions claimed by Appellants meet the requirements of Section 17302.5, they must be disallowed because of a further limitation imposed by Section 17351(e) (now Section 17285). That section prohibited the deduction of "Any amount otherwise allowable as a deduction which is allocable to one or more classes of income ... wholly exempt from the taxes imposed by this part." Since the income received by Appellants in the years 1944 through 1946 was not taxable by California, any expense allocable thereto, such as the legal fees and other expenses in question, were not deductible from their 1954 income.

Appellants' final contention, belatedly raised in their reply brief, is that pursuant to Section 17302.5 they should be

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permitted to deduct legal fees incurred in connection with a suit against Appellant Hyman Klein and others by a minority stockholder of a Canadian corporation. We have not been informed of the nature of the stockholder's suit or the amount of the legal fees paid by Appellants and attributable to this litigation. Upon the record before us, we cannot uphold Appellants' claim. (See Estate of Edward W. Clark, III, 2 T. C. 676.)

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Hyman H. and Gertrude Klein to proposed assessments of additional personal income tax in the amounts of \$407.95, \$8,513.38, \$1,279.94 and \$841.92 for the years 1950, 1952, 1953 and 1954, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of November, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

 , Member

ATTEST: Dixwell L. Pierce, Secretary